No. 80-202

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

AMERICAN EXPRESS COMPANY,
Petitioner,

v.

LOUIS R. KOERNER, SR.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR PETITIONER

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QUESTION PRESENTED FOR REVIEW

The Truth-in-Lending Act does not apply to "credit transactions involving extensions of credit for business or commercial purposes." § 104(1), 15 U.S.C. § 1603(1) (1976). Should credit extended for business or commercial purposes become subject to the Act solely because an individual, following customary business practice, may also agree to be liable for the business debt? *

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*American Express Company has no parent companies, subsidiaries (except wholly-owned subsidiaries), or affiliates that are required to be disclosed pursuant to Rule 28.1 of the Rules of this Court, other than the following: American Express Argentina, S.A. (Argentina); American Express D'Espana, S.A. (Spain); Arrendadora Commercial—Amex, S.A. (Mexico); Bancom Group, Inc. (Philippines); Egyptian American Bank (Egypt); Ivory & Sime Ltd. (Scotland); Jetamex Ltd. (United Kingdom); Pacific Bank Berhard (Malaysia); Société Francaise Du Cheque De Voyage (France); Warner Amex Cable Communications Inc.; Warner Amex Cable Communications Company; Warner Amex Satellite Entertainment Company; and Warner Amex Satellite Entertainment Corporation. Various other corporations affiliated with the Warner Amex entities listed above operate or have applied for cable television franchises in various cities throughout the country.

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BRIEF FOR PETITIONER

OPINION BELOW

The Opinion and Judgment of the Court of Appeals reversing the District Court's judgment in favor of Petitioner is reported at 615 F.2d 191 and appears in the Appendices to the Petition for Certiorari (Pet. App.) at Appendix A. The Order of the Court of Appeals denying a Petition for Rehearing appears in Appendix B to the Petition. The Memorandum Opinion and Order of the District Court is reported at 444 F. Supp. 334 and appears in Appendix C to the Petition. The Judgment of the District Court appears in Appendix D to the Petition.

JURISDICTION OF THIS COURT

The Opinion and Judgment of the Court of Appeals was entered on April 7, 1980. A timely petition for re-

hearing en banc was denied on May 12, 1980. Petitioner filed a timely petition for writ of certiorari on August 11, 1980, invoking jurisdiction under 28 U.S.C. § 1254 (1) (1976). Certiorari was granted by order of January 12, 1981. (Joint Appendix (J.A.) at 55a.)

STATUTES, REGULATION, AND INTERPRETIVE LETTERS INVOLVED IN THE CASE

The statutory provisions involved are §§ 104(1) and 161 of the Truth-in-Lending Act, 15 U.S.C. §§ 1603 (1) and 1666 (1976) (Pet. App. Appendix E). The regulation involved is a provision of the Federal Reserve Board's Regulation Z, 12 C.F.R. § 226.3(a) (1980) (Pet. App. Appendix F). This case also involves several Public Information Letters of the Federal Reserve Board (Pet. App. Appendix G).

STATEMENT OF THE CASE

The question presented by this case is a straightforward but important one: Does the Truth-in-Lending Act apply to business loans secured by an individual's personal liability? Because the Act was designed to protect individuals who obtain credit for consumer purposes, it contains a broad exemption for credit transactions for business or commercial purposes. *See* § 104(1), 15 U.S.C. § 1603(1) (1976). The Court of Appeals held that the business purpose exemption is defeated if an individual is made personally liable for a business debt.

If the decision of the Court of Appeals is allowed to stand, the commercial credit industry—borrowers and lenders alike—will be forced either to abandon use of personal liability in business credit transactions or to restructure their procedures to comply with the Truth-in-Lending Act. Personal liability is a common element in a broad range of business credit transactions, particularly those involving unincorporated businesses and small

or new corporations. Abandoning use of personal liability would adversely affect the availability and cost of credit for business borrowers. On the other hand, the Truth-in-Landing Act contains an extensive and complicated array of regulatory requirements (including those relating to disclosure, resolution of billing errors, and advertising) which were enacted with consumer credit in mind and which are not easily applied in a commercial context. Application of these requirements to business credit transactions would lead to needless disruption of creditor lending procedures, with increased costs and inconvenience for borrowers.

The facts giving rise to the litigation can be summarized briefly: On November 16, 1965, a company called John E. Koerner & Co., Inc., (the "company") applied for an American Express account. (J.A. at 25a.) At the same time the application was filed, the company requested that cards bearing the name John E. Koerner & Co., Inc., be issued to John Koerner and to the Respondent, Louis R. Koerner, Sr. ("Koerner"), both employees of the company. For Louis Koerner's card, both he and the company signed a "company account" request form. By signing, Koerner agreed to be jointly and severally liable, along with the company, for all charges incurred through use of the company card which also bore his name. (J.A. at 28a.)

The application forms requested credit information about the company, but not about Koerner or any other employee. American Express evaluated the information about the company and approved the applications. At the same time or shortly thereafter, the company apparently applied for at least three additional company cards to be issued for company employees. American Express issued these cards for Ralph E. Koerner, Dennis Thomas, and Carroll A. DeGeorge. In all, at least five cards were issued at one time or another on the company account. (Pet. App. at 3c.)

The account opened for John E. Koerner & Co. Inc., was a company account designed for business customers. (J.A. at 25a.) American Express also issues personal cards to non-business card customers. The record does not reflect whether Koerner ever applied for or received such a card. All charges for use of Koerner's company card, as well as the other company cards, were billed on one statement addressed to the company at its business address. The statement showed subtotals for each card, including the card used by Koerner. (Pet. App. at 2a; Statement of Uncontested Facts, Exhibit 3.)

In 1975, a dispute arose between the company and American Express over the billing of certain charges involving the cards of Koerner, John Koerner, and Ralph E. Koerner. The letters about the dispute were sent to American Express on John E. Koerner & Co. stationery. (J.A. at 38a, 43a.) All the disputed charges were admittedly incurred for business purposes. (J.A. at 35a-37a, 41a-42a.)

The dispute had not been resolved on September 28, 1976, when Koerner attempted to use his card at New Orleans International Airport to purchase an airline ticket for a business trip. (J.A. at 38a, 40a.) The ticket agent called American Express to check the status of the account and then (apparently at American Express' request) returned Koerner's card to him, cut in half. (J.A. at 18a.)

Koerner brought suit in the United States District Court for the Eastern District of Louisiana, claiming that revocation of his card violated § 161 of the Truth-in-Lending Act, 15 U.S.C. § 1666 (1976), a section originally enacted as part of the 1974 Fair Credit Billing Act.[1] This section prohibits, among other things, certain

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[1] Koerner also claimed that American Express violated § 127 of the Act, 15 U.S.C. § 1637 (1976), which requires certain periodic disclosures. *See* § 127(a)(8). Because Koerner asserts that the relevant portion of § 127 is made applicable to American Express

actions by a credit card issuer against a cardholder while the issuer is processing complaints concerning billing errors. The company was not joined as a plaintiff and is not a party to this litigation. Jurisdiction of the District Court was invoked under 15 U.S.C. § 1640(e) (1976) and its counterparts, 28 U.S.C. § 1331 and § 1337 (1976).

Following the recommendation of a magistrate, the District Court granted summary judgment for American Express, holding that § 161 applies only to extensions of credit for consumer purposes and therefore does not apply to company accounts. (Pet. App. at 8c-9c, 17c.) The court reached this decision after fully reviewing the language of § 161 and the language of § 104(1) of the Act, which provides an exemption for "credit transactions involving extensions of credit for business or commercial purposes." (Pet. App. at 10c, 13c.) On appeal, the Court of Appeals for the Fifth Circuit reversed.

The Court of Appeals resolved the case on a theory not addressed by the District Court or by the parties in their briefs. The court recited the holding of the District Court that § 161 is not applicable to credit transactions for business or commercial purposes, but it added that it was not deciding this issue, which it described as "difficult." (Pet. App. at 9a.) Instead, the Court concluded that it was not fair for American Express to avoid complying with the Truth-in-Lending Act because Koerner, whom the court characterized as a "consumer," had assumed liability for the use of the company card embossed with his name:

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through § 161, (J.A. at 19a), his right to assert a violation of § 127 depends on the applicability of § 161. (Pet. App. at 5c.)

In addition, Koerner alleged that American Express violated Louisiana law by committing a tort through its breach of contract. Koerner later stipulated that this claim would not reach the requisite jurisdictional amount. (J.A. at 10a-20a.)

> Koerner signed a statement joining in the application and assuming joint and several liability for any debts. Therefore, American Express could recover from him or from the company. . . . The credit card company cannot have it both ways: If it does not want to be bound by consumer lending requirements, then it should not be allowed to collect its debts from a consumer. (Pet. App. at 9a-10a.) (Footnote omitted.)

In arriving at this conclusion, the Court of Appeals recognized that it was abandoning the business purpose test required by the language of § 104(1). It also found this result justified by equitable considerations:

> Although our decision prevents application of the [§ 104(1)] exemption for 'business or commercial purposes' to [§ 161] when an individual is liable for debts incurred, this result is consonant with the purpose of the Fair Credit Billing Act of 1974—protecting consumers from the harassment of creditors. (Pet. App. at 10a.)

SUMMARY OF ARGUMENT

I

The court below held that all business debts for which an individual has assumed liability are subject to the Truth-in-Lending Act, regardless of the § 104(1) business purpose exemption. But the language and legislative history of the Act show that Congress intended the applicability of the exemption to turn on the existence of a business or commercial purpose, not on the identity of the borrower. Congress' intent has been consistently followed by the Federal Reserve Board and its staff and, until this case, by the courts.

II

As an alternative ground for its decision, the court cited the "purpose of the Fair Credit Billing Act." The Fair

Credit Billing Act—a set of amendments to the Truth-in-Lending Act passed in 1974—contains § 161, the section assertedly violated by Petitioner. But nothing in the Fair Credit Billing Act indicates that Congress intended it to have broader application than other provisions of the Truth-in-Lending Act. The language, legislative history and, indeed, the purpose of the Fair Credit Billing Act, as well as its administrative interpretation, all indicate that Congress devised the error resolution procedures of the Act to meet specific needs of consumers, and that business debtors were never expected to fall under its provisions.

III

The business purpose exemption, which the Court of Appeals' decision would undermine, reflects underlying commercial realities. The business of extending commercial credit, including commercial credit involving personal guarantees, involves procedures and business requirements quite distinct from those typical in a consumer context. Regulatory requirements devised for consumer credit cannot sensibly be applied in a commercial credit context, and Congress never intended for them to be so applied. The only foundation for the Court of Appeals' decision was its own concept of equity. But courts are not permitted to rewrite statutes to satisfy their own notions of fairness. When they attempt to do so, they upset the complex balance of regulatory and economic requirements considered by Congress.

ARGUMENT

I. ALL CREDIT TRANSACTIONS FOR BUSINESS OR COMMERCIAL PURPOSES ARE EXEMPT FROM THE TRUTH-IN-LENDING ACT, REGARDLESS OF WHETHER AN INDIVIDUAL ASSUMES LIABILITY FOR THE BUSINESS DEBT.

A. The Court of Appeals' Decision Is Contrary to the Language and Legislative History of the Act.

The ruling of the Fifth Circuit was a simple one: all loans for which "consumers" may be liable are subject to the Truth-in-Lending Act. Because American Express could not "have its cake and eat it too," the Court of Appeals concluded that if American Express did not "want to be bound by consumer lending requirements, then it should not be allowed to collect its debts from a consumer." (Pet. App. at 10a.)

This play on the word "consumer," appealingly symmetrical as it may appear, distorts both the language and the legislative history of the Truth-in-Lending Act. In adopting the Act, Congress exempted all credit transactions having a business or commercial purpose, regardless of the identity of the obligor. The exemption turns on the nature of the loan transaction, not on a characterization of the debtor.

1. *The Language of the Act Clearly Exempts All Lending for Business or Commercial Purposes.*

We start with the language of the Act itself.[2] Here, the express language of the statute is clear. Section 104(1) of the Act provides a blanket exemption for all "credit transactions involving extensions of credit for

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[2] This Court has found that "there is no need to refer to the legislative history where the statutory language is clear." *Ex Parte Collett*, 337 U.S. 55, 61 (1949); *see Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 201 (1976).

business or commercial purposes." The language is phrased in terms of the purpose of the extension of credit, not the identity of the debtor. Moreover, the Truth-in-Lending Act is structured in such a way that the § 104(1) business purpose exemption applies to all provisions of the Act, with the exception of three sections not involved in the case which are specifically excepted from its operation;[3] the introductory language to § 104 states flatly that "[t]his subchapter [identifying the Truth-in-Lending Act] does not apply" to the transactions exempted in § 104.

If all this were not clear enough, the remainder of § 104(1) makes Congress' intent unmistakable. In addition to the exemption for credit transactions for business or commercial purposes, the section contains an additional exemption for extensions of credit to "organizations." Section 103(c) of the Act defines an organization as a "corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association." 15 U.S.C. § 1602(c) (1976). It is thus evident that Congress knew how to make an exemption turn on the identity of the obligor and that it in fact had exempted all extensions of credit to the most common business entities: corporations and partnerships. The business purpose exemption, if it is not to be viewed as meaningless surplusage, obviously must have been intended to go further, *i.e.*, to exempt all business loans from the Act, regardless of whether the debtor was a corporation, a partnership, or an individual.

Other language in the Act also shows that Congress was limiting its attention to credit extended to natural persons who were borrowing for personal, family, or household purposes, and that individuals borrowing for business purposes were never intended to be covered.

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[3] These three sections, §§ 132-134, 15 U.S.C. § 1642-44 (1976), pertain to issuance of unsolicited cards, limits of liability, and fraud.

Each of the major substantive sections of the Act, including the general section requiring disclosures, § 121(a), 15 U.S.C. § 1631(a) (1976), and the later-added section involving billing errors that is involved in this case, § 161, 15 U.S.C. § 1666 (1976), refers to extensions of "consumer credit." The term "consumer" is, in turn, defined in § 103(h), 15 U.S.C. § 1602(h) (1976):

> The adjective "consumer", used with reference to a credit transaction, characterizes the transaction as one in which the party to whom credit is offered or extended is a natural person, *and* the money, property, or services which are the subject of the transaction are primarily for personal, family, household, or agricultural purposes. (Emphasis added.)[4]

The use of the word "and" in this definition makes it clear that credit extended to natural persons is covered *only* when the credit is being extended for personal, family, or household purposes. Credit extended to individuals for business purposes is not covered by the Act, even without regard to the exemption provided by § 104(1).

2. *The Legislative History of the Act Also Shows that the Business Purpose Exemption Was Intended to Apply to All Business Lending.*

The evolution of the business purpose exemption supports this analysis. The earliest Truth-in-Lending bills, introduced by the late Senator Paul Douglas, had no statutory business exemption. These early bills would have covered *all* credit transactions involving any "person," defined to include, *inter alia*, an individual, partnership,

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[4] Reference to "agricultural purposes" will be deleted from this definition of "consumer," effective March 31, 1982, by operation of the Truth-in-Lending Simplification and Reform Act, §§ 603(a), 625(a), Pub. L. 96-221, 94 Stat. 132 (1980).

or corporation.[5] This broad coverage was limited only by a delegation of authority to the Federal Reserve Board to establish exemptions where it determined that the protections of the Act were not necessary:

> The Board shall exempt those credit transactions involving extensions of credit to business firms, governments, or governmental agencies or instrumentalities as to which it determines adherence to the disclosure requirements of this Act is not necessary to carry out the purpose of this Act.[6]

These early versions encountered stiff resistence, and although hearings were held, the bills never reached a vote in either house. In order to meet some of the objections to the earlier bills, Senator Proxmire introduced a narrower bill in 1967. The new bill, S. 5, started out with the same broad provisions on coverage as the earlier bills,[7] but now a new statutory exemption had been added. It covered:

> credit transactions involving extensions of credit to business firms as such, governments, or governmental agencies or instrumentalities.[8]

This exemption—like the one created by the Fifth Circuit in its opinion—would have turned solely on the identity of the debtor. Debts owed by individuals would be covered; debts owed by "businesses as such" would not. But Congress consciously decided to broaden the exemption. Following hearings on S. 5, where the scope

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[5] S. 750, 88th Cong., 1st Sess., §§ 3(2), 3(5), 4(a) (1963); S. 1740, 87th Cong., 1st Sess., §§ 3(2), 3(5), 4(a) (1961); S. 2755, 86th Cong., 2d Sess., §§ 2(1), 2(3), 3 (1960).

[6] S. 750, § 5(a); S. 1740, § 5(a). *See* S. 2755, § 4 ("The Board shall . . . exempt those transactions between business firms as to which it determines adherence with the disclosure requirements of this Act is not necessary to carry out the purpose of this Act.")

[7] S. 5, 90th Cong., 1st Sess., §§ 3(2), 3(9), 4 (1967).

[8] S. 5, § 8(1).

of the exemption was put in issue,[9] the Senate changed the exemption for "business firms as such" to the present exemption of "credit transactions involving extensions of credit for business or commercial purposes." As the Senate Report explained:

> The original S. 5 would have exempted credit to "business firms as such." This left an element of doubt with respect to credit granted to farmers, proprietorships, or self-employed professionals. This doubt is now clarified by the definition of credit under section 3(b) as credit for person [sic] other than an organization and "primarily for personal, family, household, or agricultural purposes." Credit for business or commercial purposes is exempted.[10]

The exemption and definition described in this Senate Report survived consideration in the House [11] and remained in the bill as finally enacted.

The reason for Congress' express decision to focus only on consumer credit, and to exclude all coverage of business credit, is apparent in the record. In numerous hearings held over a seven-year period, Congress collected evidence of a wide variation in consumer credit disclosure practices that made it difficult for consumers to learn the true cost of credit.[12] Congress determined that the

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[9] Hearings on S. 5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 664-65, 668-69 (1967).

[10] S. Rep. No. 392, 90th Cong., 1st Sess. 22 (1967). *See also* 113 Cong. Rec. 14694, 14695 (1967).

[11] H.R. 11601, 90th Cong., 1st Sess., §§ 202(b), 202(c), 203(n)(1) (1967).

[12] Hearings on H.R. 11601 Before the Subcomm. on Consumer Affairs of the House Comm. on Banking and Currency, 90th Cong., 1st Sess. (1967); Hearings on S. 5 Before the Subcomm. on Financial Institution of the Senate Comm. on Banking and Currency,

appropriate response involved a strategy of full disclosure, tailored to the specific consumer credit problems that had been discussed during the hearings.[13] At the same time, Congress also determined that the new law should not cover transactions having a business or commercial purpose:

> By limiting the bill to the field of consumer credit, the committee believes it is providing disclosure requirements in an area where it is most essential. Most businesses or corporations are in a good position to judge the relative worth of alternative credit plans and by and large do not require the special disclosure protections provided by the bill.[14]

In short, Congress never intended to give the Act the broad coverage mandated by the Fifth Circuit's opinion. The Act was intended to cover only consumer credit transactions, and not transactions involving a business purpose, even where an individual might be liable for the business debt.

B. All Prior Administrative and Judicial Rulings Concerning the Business Purpose Exemption Have Applied the Exemption to All Business Loans, Even Those Made to Individuals.

Until this case was decided, every relevant administrative and judicial interpretation of the business purpose exemption had given it full scope, consistent with the Congressional intent described above.

90th Cong., 1st Sess. (1967); Hearings on S. 750 Before a Subcomm. of the Senate Comm. on Banking and Currency, 88th Cong., 1st & 2nd Sess. (1963-64); Hearings on S. 1740 Before a Subcomm. of the Senate Comm. on Banking and Currency, 87th Cong., 2d Sess. (1962); Hearings on S. 1740 Before a Subcomm. of the Senate Comm. on Banking and Currency, 87th Cong., 1st Sess. (1961).

[13] S. Rep. No. 392, 90th Cong., 1st Sess. 1 (1967); H. Rep. No. 1040, 90th Cong., 1st Sess. 6-7 (1967).

[14] S. Rep. 392, at 7.

1. *Numerous Federal Reserve Board Rulings on the Business Purpose Exemption Demonstrate that the Exemption Applies to Individuals.*

Under authority granted by Congress to interpret and administer the Truth-in-Lending Act, the Federal Reserve Board and its staff have issued a number of administrative rulings concerning the relevant sections of the Act. 15 U.S.C. § 1604 (1976). These rulings are contained in Regulation Z, 12 C.F.R. § 226.1 *et seq.* (1980), the basic regulatory implementation of the Act, and in a number of interpretive letters issued by the Board and its staff.

Under *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980), Regulation Z and the interpretive rulings play a critical role in interpretation of the Truth-in-Lending Act. In *Milhollin*, this Court held that the courts' "traditional acquiescense in administrative expertise is particularly apt" where the Federal Reserve Board and its staff interpret the Truth-in-Lending Act. *Id.* at 566. The court emphasized that "congress specifically designated the Federal Reserve Board and its staff as the primary source for interpretation and application of truth-in-lending law[s]." *Id.* Thus, Regulation Z serves to "elaborate and expand the legal framework" provided by the Act. *Id.* at 560.[15] Where the express language of the Act and Regulation Z do not resolve an issue of interpretation:

> [u]nless demonstrably irrational, Federal Reserve Board staff opinions construing the Act should be dispositive

Id. at 565.[16]

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[15] *See also Mourning* v. *Family Publication Service, Inc.*, 411 U.S. 356 (1973).

[16] This Court is currently considering another case raising questions concerning the proper application of the *Milhollin* rule. *Anderson Bros. Ford* v. *Valencia, cert. granted*, 49 U.S.L.W. 3350 (Nov. 11, 1980), No. 80-84.

Under the directive of *Milhollin*, we look first to the express language of Regulation Z. Here, Regulation Z exempts "[e]xtensions of credit . . . for business or commercial purposes, other than agricultural purposes." 12 C.F.R. § 226.3(a) (1980). Like its counterpart in the Act, this exemption turns on the purpose of the transaction rather than the identity of the borrower.

This focus on purpose is also evident in the regulatory definition of "consumer credit," which is derived from the statutory definition of "consumer" described above. *See supra* at 10. Consumer credit is defined to mean

> credit offered or extended to a natural person, in which the money, property or service which is the subject of the transaction is primarily for personal, family, household or agricultural purposes.

12 C.F.R. § 226.2(p) (1980). Under these provisions, borrowing by an individual natural person is clearly not covered if the credit transaction at issue is for a business or commercial purpose.

Various interpretations issued by the Federal Reserve Board staff also show that the business purpose exemption applies to individuals. In one opinion letter directly on point, the staff ruled that the Truth-in-Lending Act would not apply where a corporation and a corporate employee are jointly and severally liable for obligations incurred on the employee's credit card, issued to the corporation for use by the employee. The staff stated that "[i]f the credit is for business or commercial purposes, it would not be subject to Truth-in-Lending by virtue of the exemption in § 226.3(a)." Public Information Letter No. 727, November 13, 1975, issued by Griffith L. Garwood.

Other staff opinion letters are similar. The staff has advised that where a corporation's principal shareholder guarantees a business loan made to the corporation, the transaction is exempt from the Truth-in-Lending Act

even though the shareholder provides his principal residence as security for the loan. Public Information Letter No. 277, March 10, 1970, issued by Kenneth A. Kenyon.[17] The staff has also determined that where credit is extended to an individual who buys securities to supplement his business income as a merchant, the transaction is exempt from coverage, even though the only obligor is a natural person. Public Information Letter No. 821, July 18, 1974, issued by Jerauld C. Kluckman. Because these rulings are not demonstrably irrational, they are dispositive. *Ford Motor Credit Corp.* v. *Milhollin*, 444 U.S. at 565.

2. *Under All Previous Court Rulings, the Business Purpose Exemption Applies to Individuals.*

Nor does the case law provide any support for the Court of Appeals' decision. The Tenth Circuit recently reviewed the case law interpreting the business purpose exemption and noted that "[c]ases considering whether a transaction is primarily consumer or commercial in nature look to the transaction as a whole and the purpose for which credit was extended." *Gallegos* v. *Stokes*, 593 F.2d 372, 375 (10th Cir. 1979). *See also Redhouse* v. *Quality Ford Sales, Inc.*, 511 F.2d 230, 234 (10th Cir. 1975). A recent ruling by another panel of the Fifth Circuit is in accord: "The courts will look to the purpose of the loan to determine whether it is covered by the Act." *Poe* v. *First National Bank*, 597 F.2d 895, 896

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[17] *See also* Public Information Letter No. 751, January 14, 1974, issued by Jerauld C. Kluckman (loan taken by individual exclusively for business purposes is exempt from coverage of the Truth-in-Lending Act, regardless of fact that loan will be secured by private home); Public Information Letter No. 663, January 23, 1973, issued by Jerauld C. Kluckman (loan transaction for commercial purposes is exempt from coverage of the Truth-in-Lending Act, regardless of fact that loan is secured by antiques used for personal, family, or household purposes).

(5th Cir. 1979).[18] Numerous district courts have either expressly endorsed[19] or implicitly applied[20] the same principle.

A review of these cases reveals that no court has ever before held that the Truth-in-Lending Act is applicable to a business loan transaction simply because an individual is liable for the business debt. Instead, the case law shows that once a business purpose is found, the courts uniformly hold that the § 104(1) exemption is applicable without regard to the identity of the debtor. In the *Poe* case cited above, for example, another Fifth Circuit panel specifically found it irrelevant that individual corporate officers had agreed to be personally liable for a corporation's debts; the court found it crucial that "the purpose of the transaction was to finance a corporation and its business." *Poe* v. *First National Bank*, 597 F.2d at 895.

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[18] *Citing Sapenter* v. *Dreyco, Inc.*, 326 F. Supp. 871 (E.D. La.), *aff'd*, 450 F.2d 941 (5th Cir. 1971), *cert. denied*, 406 U.S. 920 (1972); *Tower* v. *Home Constr. Co.*, 458 F. Supp. 112, 116-17 (S.D. Ala. 1978).

[19] *See, e.g., Weingarten* v. *First Mortgage Co.*, 466 F. Supp. 349, 352 (E.D. Pa. 1979) ("[t]he cases which have been called to this Court's attention appear to hold without exception that where the credit transaction is for a business purpose rather than for a personal, family, household or agricultural purpose, then the transaction is not covered by the Act"); *Tower* v. *Home Constr. Co.*, 458 F. Supp. 112, 116-17 (S.D. Ala. 1978); *Smith* v. *Chapman*, 436 F. Supp. 58, 61 (W.D. Tex. 1977), *aff'd*, 614 F.2d 968 (5th Cir. 1980); *Puckett* v. *Georgia Homes, Inc.*, 369 F. Supp. 614, 618-20 (D.S.C. 1974); *Adema* v. *Great N. Dev. Co.*, 374 F. Supp. 318, 319-20 (N.D. Ga. 1973); *Brill* v. *Newport Nat'l Bank*, Consumer Credit Guide (CCH) ¶ 99,057 (S.D.N.Y. 1973); *Sapenter* v. *Dreyco, Inc.*, 326 F. Supp. 871, 873-74 (E.D. La.), *aff'd*, 450 F.2d 941 (5th Cir. 1971), *cert. denied*, 406 U.S. 920 (1972).

[20] *See, e.g., Vines* v. *Hodges*, 422 F. Supp. 1292, 1297 (D.D.C. 1976); *Sambolin* v. *Klein Sales Co.*, 422 F. Supp. 625, 627 (S.D. N.Y. 1976); *Kenney* v. *Landis Financial Group, Inc.*, 376 F. Supp. 852, 853 (N.D. Iowa 1974).

Other cases applying the § 104(1) exemption show that a finding of business purpose is dispositive even where the debtor is an individual who is arguably less sophisticated in credit transactions than the businessman Respondent in this case. In a case before the Tenth Circuit, the Court of Appeals reversed a trial court ruling that the Truth-in-Lending Act applied to the purchase of a pick-up truck by two Navajo Indians. The court found that summary judgment in favor of the Indians was improper because the trial court had failed to determine whether the truck was to be used for business or for consumer purposes. *Redhouse* v. *Quality Ford Sales, Inc.*, 511 F.2d at 234.

Similarly, in *Tower* v. *Home Construction Co.*, 458 F. Supp. 112, 117 (S.D. Ala. 1978) the court held that a plaintiff who had secured credit for repairs to a private house was commercially moticated and thus not protected by the Truth-in-Lending Act because the house was being rented, even though the plaintiff ultimately intended to retire there. Likewise, in *Puckett* v. *Georgia Homes, Inc.*, 369 F. Supp. 614, 619-20 & n.6 (D.S.C. 1974), the court held that the plaintiff, a barber earning $5,000 a year, was not entitled to the protections of the Truth-in-Lending Act in securing credit to purchase a mobile home which he intended to rent.

II. NOTHING IN THE FAIR CREDIT BILLING ACT INDICATES THAT CONGRESS INTENDED IT TO HAVE BROADER APPLICATION THAN THE REMAINDER OF THE TRUTH-IN-LENDING ACT.

As an alternative ground for its holding that the business purpose exemption is not applicable where an individual assumes liability for a business debt, the Court of Appeals cited the purpose of the Fair Credit Billing Act to justify abandonment of the business purpose exemption. But nothing in the Fair Credit Billing Act indicates that Congress intended it to have broader application than the other provisions of Truth-in-Lending.

A. The Text And Legislative History of the Fair Credit Billing Provisions, as Well as Their Administrative Interpretation, Show that They Have No Broader Application than the Remainder of the Truth-in-Lending Act.

1. *The Language and Legislative History of the Fair Credit Billing Act Indicate that It is Subject to the Business Purpose Exemption.*

The business purpose exemption provided by § 104(1) is, by its language, applicable to the entire Act.[21] An explicit statement of Congressional intent would be required to prevent the exemption from applying in the context of this case. No such statement exists.

Moreover, the express language of § 161, the particular provision of the Fair Credit Billing Act assertedly violated by Petitioner, shows unequivocally that this section was intended to be fully subject to the business purpose exemption. Section 161 concerns billing errors in a "statement of the obligor's account in connection with an extension of *consumer credit.*" § 161(a), 15 U.S.C. § 1666(a) (1976) (emphasis added). The specific subsection of § 161 applicable to Koerner's claim below governs the closing of an "open-end *consumer credit* plan" where the obligor has given the requisite notice of an alleged billing error. § 161(d), 15 U.S.C. § 1666(d) (1976) (emphasis added). Because the references to consumer credit serve to limit the operation of § 161 to non-business transactions,[22] the text of § 161 cannot be read to preclude application of the business credit exemption contained in § 104(1).

The legislative history of the Fair Credit Billing provisions supports this interpretation. The Fair Credit

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[21] Section 135 makes § 104(1) inapplicable to three sections of the Act not involved in this case, §§ 132-34.

[22] *See supra* at 10, 15.

Billing Act grew out of congressional concerns that consumers had no effective recourse against creditors who failed to respond adequately to allegations of billing errors or who engaged in questionable billing practices. The Senate report accompanying the bill that ultimately was enacted focused solely on problems suffered by consumers in these areas. S. Rep. No. 278, 93d Cong., 1st Sess. 2-7 (1973).[23] Business credit cards were not a subject of concern. As the author of the law, Senator Proxmire, noted in connection with a predecessor to the bill that was ultimately enacted:

> It is my understanding, that even if [the credit card] is in your name, and not the name of the firm, if you use it for business purposes, you wouldn't have the protection of this bill.[24]

In further comments on the same bill, Senator Proxmire added:

> As you know, this law would not reach business transactions. By the amendment to the Truth-in-Lending Act business transactions are exempt.[25]

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[23] The Fair Credit Billing provisions were considered primarily by the Senate. The House did not engage in full debate on these provisions because they were added by the Senate to H.R. 11221, 93d Cong., 1st Sess. (1973), an unrelated House bill concerning depository institutions, following passage of that bill by the House. *See* 120 Cong. Rec. 19209-19214 (1974). The Conference Committee on H.R. 11221 accepted the new Fair Credit Billing provisions, H. Rep. No. 1429, 93d Cong., 2nd Sess. (1974), and the bill reported by the Conference was passed by the House even though the new provisions had never been the subject of debate by the full House. *See* 120 Cong. Rec. 34763-34770 (1974). The full history of the passage of the Fair Credit Billing amendments is set out at Pet. App. 18c-20c & n.1.

[24] Hearings on S. 652 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing and Urban Affairs, 92d Cong., 1st Sess. 66 (1971).

[25] *Id.* at 375.

Because the bill to which Senator Proxmire referred, S. 652, 92nd Cong., 1st Sess. (1971), was later resubmitted and enacted with only minor modification—none affecting the business purpose exemption—these statements apply with equal force to the Fair Credit Billing Act in its present form.

2. *The Specific References to Business Credit Cards in Section 135 of the Act Provide Additional Evidence that the Business Purpose Exemption Was Intended to Apply to the Fair Credit Billing Provisions.*

The Truth-in-Lending Act contains a section dealing specifically with the application of the business purpose exemption to business credit cards. That section—§ 135, 15 U.S.C. § 1645 (1976)—was added to the Act at the same time the Fair Credit Billing amendments were adopted and provides that the business purpose exemption does not apply to three specific credit card provisions which had been added to Truth-in-Lending in 1970. Section 135 does not, however, purport to prevent the application of the business purpose exemption to the Fair Credit Billing provisions, which Congress was enacting at precisely the same moment. This crucial omission from § 135 provides strong additional evidence that the Fair Credit Billing Act was fully subject to the business purpose exemption and was not intended to apply to credit extended for business or commercial purposes.

In 1970, Congress had added three sections to Truth-in-Lending to deal with specific credit card problems. These sections—§§ 132, 133, and 134 of the Act, 15 U.S.C. §§ 1642-44 (1976)—prohibit issuance of unsolicited cards, limit cardholders' liability for unauthorized use of their cards, and make fraudulent use of cards a federal crime. The language of these provisions shows that they apply to all credit cards, including business cards.[26]

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[26] The three provisions speak broadly in terms of regulations attaching to a "credit card" or in terms of the rights of a "card-

Moreover, in each case, Congress was addressing problems common to all types of cards. Among other things, the provisions concerning unsolicited credit cards were intended to prevent theft in the mails,[28] the provisions on limitations of liability were intended to provide card issuers with incentives to take precautionary actions against fraudulent use of credit cards,[28] and the provisions

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holder," defined in the 1970 amendments to mean "any *person* to whom a credit card is issued or any *person* who has agreed with the card issuer to pay obligations arising from the issuance of a credit card to another person." 15 U.S.C. § 1602(m) (1976) (emphasis added). Because a person includes an "organization," defined to include a "corporation," 15 U.S.C. §§ 1602(c), (d) (1976), a "cardholder" for purposes of the 1970 amendments obviously extends far beyond an individual using a credit card for consumer purposes.

The fact that the 1970 amendments were incorporated in the Truth-in-Lending Act could not, by itself, lend much weight to the argument that they were intended to be subject to the business purpose exemption. Early legislative proposals would have placed these provisions under the Deposit Insurance Act, *see* H.R. 12646, 90th Cong., 1st Sess. (1967), or under Title 39 of the United States Code, which deals with the Postal Service, *see* H.R. 16542, 91st Cong., 2d Sess. (1970). It appears that the provisions were ultimately added to the Truth-in-Lending Act to assure administration of the provisions by the Federal Reserve Board, both because of the regulatory machinery already in place and because of the Board's regulatory jurisdiction over banks. *See* Hearings on S. 721 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency, 91st Cong., 1st Sess. 7-8 (1969) (Letter to Sen. Sparkman, Committee Chairman, from the Federal Reserve Board); *id.* at 14, 19-20, 28 (statement of Andrew Brimmer, Member, Federal Reserve Board, and comments by Sen. Proxmire); *id.* at 40-42 (statement of Paul Rand Dixon, Chairman, Federal Trade Commission, and comments by Sen. Proxmire).

[27] S. Rep. No. 739, 91st Cong., 2d Sess. 4 (1970); 116 Cong. Rec. 11828, 11833 (1970) (comments by Sen. Proxmire), *id.* at 11831 (comments by Sen. McIntyre); *id.* at 11841 (comments by Sen. Percy).

[28] S. Rep. No. 739, 91st Cong., 2d Sess. 5 (1970). *See* Hearings on S. 721 Before the Subcomm. on Financial Institutions of the

concerning fraud were directed against misuse of credit cards in general rather than the misuse of credit cards used for consumer purposes.[29]

The Federal Reserve Board found this intent implicit in the 1970 amendments and promulgated revisions to Regulation Z specifying that the new sections were not subject to the business purpose exemption. 37 Fed. Reg. 24337 (1972) (promulgation of amended regulation); 37 Fed. Reg. 16408 (1972) (proposal to promulgate amended regulation). After the Board recommended in its 1972 Annual Report that the Truth-in-Lending Act be amended to make the coverage of the business purpose exemption explicit, *see* 119 Cong. Rec. 4595, 4597 (1973), Congress passed § 135 expressly excepting the three 1970 amendments from the operation of the exemption.

Indeed, in making the business purpose exemption inapplicable to the three 1970 amendments, Congress recognized that one of the amendments created special problems for business credit card systems, and Congress therefore adopted special rules making the amendment in question applicable to business cards only in certain defined situations.[30] In contrast, the Court of Appeals deci-

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Senate Committee on Banking and Currency, 91st Cong., 1st Sess. 39-40 (1969) (statement of Paul Rand Dixon, Chairman, Federal Trade Commission); *id.* at 66 (statement of Robert Meade, Director, Legislative Affairs, President's Committee on Consumer Interests).

[29] 116 Cong. Rec. 11839-11840 (1970) (statements of Sen. Long upon introducing the fraud amendment).

[30] Section 135 provides as follows:

> The exemption provided by section [104(1)] does not apply to the provisions of sections [132], [133], and [134], except that a card issuer and a business or other organization which provides credit cards issued by the same card issuer to ten or more of its employees may by contract agree as to liability of the business or other organization with respect to unauthorized use of such credit cards without regard to the provisions of section [133], but in no case may such business or

sion would make all of the Fair Credit Billing Act applicable to business credit transactions involving individual liability without making any modifications in light of the special problems typical in the business context. *See infra* at 41-42.[31]

One of the 1970 amendments was the subject of two Court of Appeals decisions on which Respondent has relied extensively. In *American Airlines, Inc.* v. *Remis Industries, Inc.*, 494 F.2d 196 (2d Cir. 1974), and *Credit Card Service Corp.* v. *FTC*, 495 F.2d 1004 (D.C. Cir. 1974), the courts held that § 104(1) does not prevent the application of § 133 of the Act (limiting cardholder liability for unauthorized credit card use to $50) to business credit cards. The two cases, decided prior to passage of § 135 and later codified in that section, dealt only with the 1970 amendments to the Truth-in-Lending Act, not the 1974 amendments. Thus, they have no direct application to this case. Moreover, the reasoning of the two decisions is inapposite. As we have shown, the language, legislative history, and administrative construction of the 1970 amendments all show that Congress intended

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other organization or card issuer impose liability upon any employee with respect to unauthorized use of such a credit card except in accordance with and subject to the limitations of section [133].

[31] When the Federal Reserve Board, in its 1972 Annual Report, described its amendment to the regulation excepting the provisions concerning issuance of unsolicited cards, limits on liability, and fraud from the business purpose exemption, it took the position that the "amendments do not affect the business exemption in its application to the disclosure, rescission and advertising requirements." 119 Cong. Rec. 4595 (1973). *See also* 37 Fed. Reg. 24337, 24339 (1972) (promulgation of amended regulations); 37 Fed. Reg. 16408 (1972) (proposal to promulgate amended regulations). Thus, it intended the statutory amendments to have a similar limited effect. *See* 1972 Annual Report, *supra*, 119 Cong. Rec. at 4597. There is every indication that Congress agreed with the Board, for the Annual Report was included in the record at the time Senator Proxmire introduced the bill incorporating the Board's recommendation. 119 Cong. Rec. 4595 (1973).

for the 1970 amendments to apply to all credit cards, not just those issued for consumer credit purposes. By contrast, the language, legislative history, and administrative construction of the 1974 Fair Credit Billing amendments show that these provisions were to be fully subject to the business purpose exemption.

3. *The Administrative Interpretation of the Fair Credit Billing Provisions Confirms that They Are Subject to the Business Purpose Exemption.*

The Federal Reserve Board staff has specifically ruled on the precise issue involved in this case. In a letter cited but ignored below, the staff responded to an inquiry concerning the applicability of Fair Credit Billing Act requirements to company cards "used by employees to purchase goods or service required for the performance of their job." The staff took the position that "the requirements of Fair Credit Billing do not apply to card issuers" in such situations. Public Information Letter No. 1004, February 10, 1976, issued by D. Edwin Schmelzer.[32]

A proposed revision of Regulation Z containing a codification of previous staff interpretations has recently been promulgated by the Board pursuant to the Truth-in-Lending Simplification and Reform Act. Pub. L. 96-221, 94 Stat. 132 (1980). 45 Fed. Reg. 80648-738 (1980). This proposal, while not yet issued as a final regulation, reaffirms the staff's views as set forth in the 1976 interpretive letter. The proposal states:

> This regulation does not apply to the following:
>
> (a) *Business, commercial, agricultural, or organizational credit.* (1) An extension of credit primarily for a business, commercial or agricultural purpose.

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[32] *See also* Federal Reserve Board, 62d Annual Report of the Board of Governors of the Federal Reserve System at 335, 336 (1976) ("The Fair Credit Billing Act and its implementing regulations establish an error resolution procedure for *consumers* to utilize in resolving credit billing disputes promptly and fairly.") **(emphasis added).**

(2) Credit extended to organizations, including credit to governmental agencies or instrumentalities.*

* Extensions of credit that are exempt under paragraphs (a) (1) and (2) remain subject to the provisions governing the issuance of credit cards and the liability for their unauthorized use, as set forth in §§ 226.12(a) and (b).

45 Fed. Reg. 80697 (1980). Under this formulation, the exemption clearly applies to all the provisions of the revised Regulation Z other than the designated sections that are specifically expected. Because the Fair Credit Billing provisions are not among the excepted sections—pertaining to issuance of unsolicited cards and liability for unauthorized use of cards—they are fully subject to the exemption.

The formulation of the Fair Credit Billing provisions in the proposed regulation also makes clear the Board's view that these provisions apply only to consumer, and not business, transactions. These provisions are made applicable to "cardholders," as newly defined in the proposed regulations.[33] Interpreting the new definition, the Board states:

> The present proposal provides that a "cardholder" means a natural person to whom a credit card is

[33] The proposed regulations define "cardholder" as follows:

> *"Cardholder"* means a natural person to whom a credit card is issued upon the request or application of that person for consumer credit purposes, or a natural person who has agreed with the card issuer to pay obligations arising from the issuance of a credit card to another person. For the purposes of §§ 226.12(a) and (b) of Subpart B, "cardholder" also includes any person to whom a credit card is issued upon the request or application of that person for any purpose, including business, commercial, or agricultural use, or a person who has agreed with the card issuer to pay obligations arising from the issuance of such a credit card to another person.

§ 226.2(a), 45 Fed. Reg. 80695-96 (1980).

Proposed § 226.13, setting forth the provisions on billing error resolution, will apply to "consumers," and proposed § 226.2(a) defines "consumers" to include "cardholders" as defined above. 45 Fed. Reg. 80696 (1980).

> issued for consumer credit purposes or a natural person who is a co-obligor or guarantor for such a card. In addition, for the limited purposes of the requirements of the sections on issuance and liability of credit cards, a "cardholder" includes *any* person, including organizations, to whom a credit card is issued for any purpose, including business, agricultural, or commercial.

45 Fed. Reg. 80651 (1980) (emphasis in original). Because the Fair Credit Billing provisions are not among those subject to the broader definition of cardholder, only persons who are liable for credit cards issued for *consumer credit* purposes, defined to mean credit "primarily for personal, family or household purposes," [34] can claim the benefit of those provisions. Thus, according to the Board's interpretation, the Fair Credit Billing provisions are not applicable where the credit card is issued for business or commercial purposes even if a natural person holds the card.

The Board makes this explicit in its commentary on cards used for both business and personal purposes.

> When a card is issued to an individual for consumer purposes, the mere fact that an organization has guaranteed to pay the debt does not remove it from the coverage of the consumer credit sections of the regulation. On the other hand, *when a card is issued for business purposes, the fact that an individual uses it for consumer purchases does not subject the card issuer to the provisions on periodic statements, billing error resolution, and other consumer protections.*

45 Fed. Reg. 80651 (1980) (emphasis added).

The ruling of the Federal Reserve Board staff, affirmed by the Board in the proposed revision to Regulation Z, is entitled to decisive weight under *Milhollin*. See *supra* at 14.

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[34] Proposed Regulation § 226.2(a), 45 Fed. Reg. 80696 (1980).

B. The Business Purpose Exemption Is Readily Applicable to the Fair Credit Billing Provisions As They Apply to Business Credit Cards.

The Court of Appeals appeared doubtful that § 104(1) could be applied to the Fair Credit Billing provisions because "it is difficult to formulate a test for application of any business exemption" where a credit card may be used for both business and consumer purposes. (Pet. App. at 9a.) It rejected the test adopted by the district court on the ground that it would "be totally unwieldy," *citing American Airlines, Inc.* v. *Remis Industries, Inc.*, 494 F.2d at 201. (Pet. App. at 9a.) But the holding of the district court, even if it were not required by the explicit language and history of the Act, does not raise the problems suggested by the Court of Appeals.

The District Court ruled that in applying the § 104(1) exemption in this case, the purpose of the credit card should be determined on the basis of a " 'prospective predominant use' test, one applied at the opening of an account and based on the reasonably anticipated predominant use thereof." (Pet. App. at 12c.) The court also indicated that a presumption as to prospective predominant use could reasonably be established on the basis of the cardholder's status as an individual or a company and the nature of the liability involved:

> [W]e believe it may be reasonably said that, in the majority of credit card accounts opened in the name of individuals who assume sole liability for debts to be incurred, predominant usage for non-business purposes is contemplated. Short of a prospective expression by the parties involved negativing such an intent, these accounts should be characterized as consumer credit accounts. . . . Just as plainly, in the majority of accounts opened in the names of companies and relying in large part on company credit, such as the account involved in this litigation, it would be reasonable to anticipate predominant use

for business or commercial purposes. (Pet. App. at 12c.)

Under the plain language of the Truth-in-Lending Act, this ruling was correct. The applicability of § 104(1) to credit cards depends on the purpose for which the credit card account is opened. Section 104(1) exempts from the Truth-in-Lending Act "*credit transactions* involving extensions of credit for business or commercial purposes." (Emphasis added.) Because of the broad definition of credit included in the Act, it is clear that the opening of a credit card account is a "credit transaction."[35] It is to this transaction that the business purpose exemption should be applied.[36]

Notwithstanding the doubts of the Court of Appeals, there is no insuperable difficulty in determining the purpose for which a credit card account is opened. At any time a credit account of any type is opened, creditors are obliged to decide the purpose of the account in order to determine whether to make the required initial disclosures under Truth-in-Lending. It is not at all anoma-

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[35] As defined in the Act, credit includes not only the right to defer payment on a particular debt, but also the right to incur debts and defer payment of them. § 103(e), 15 U.S.C. § 1602(e) (1976); 12 C.F.R. § 226.2(q) (1980). Therefore, a credit card account—representing the "right to incur debts and defer payment on them"—constitutes "credit" for purposes of the Truth-in-Lending Act, and the opening of the account involves a credit transaction.

[36] In an analogous context, the Federal Reserve Board implicitly found that "the opening and use of an open end credit account or an entire credit account would be considered a single 'transaction.'" Federal Reserve Board, Annual Report to Congress on Truth-in-Lending for 1972, 119 Cong. Rec. 4596 (1973). The issue before the Board was the meaning of § 130 of the Act, concerning civil liability. In relevant part, § 130 provided that a $100 minimum liability attached to any credit transaction where proper disclosure was not made. 82 Stat. 157 (1968) (current version at 15 U.S.C. § 1640 (1976)).

lous for the credit card issuer to be required to make the same determination with respect to a credit card account.[37]

Indeed, the credit card issuer must know, at the time the account is opened, whether or not the Truth-in-Lending Act is applicable. The procedures used to service and maintain a credit card account must be in place when the account is opened. The procedures cannot change with each use of the card. Accordingly, the purpose for which the account is opened must as a practical matter determine whether § 104(1) will be applicable, even if the account is subsequently used at times for different purposes.[38]

The fact that some personal transactions may show up on a business account should not require a different result. Under both the Act and Regulation Z, consumer credit is defined to mean credit where the subject of the transaction is *primarily* for personal, family, household, or agricultural purposes.[39] § 103(h), 12 C.F.R. § 226.2

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[37] A similar determination must be made under Article 9 of the Uniform Commercial Code, which classifies goods used as collateral for a debt into one of four categories: consumer goods, equipment, inventory, or farm products. U.C.C. § 9-109. The classification required by Article 9 has been interpreted to depend on the purpose for which the goods will be used, evaluated prospectively as of the time the security agreement is signed. *See Cessna Finance Corp.* v. *Pivo*, 58 Cal. App. 3d 381, 129 Cal. Rptr. 888, 891 (1971); *Franklin Investment Co.* v. *Homburg*, 252 A.2d 95, 96-98 (D.C. Ct. App. 1969); *McGehee* v. *Exchange Bank & Trust Co.*, 561 S.W.2d 926, 930 (Tex. Ct. Civ. App. 1978); *Commercial Credit Equipment Corp.* v. *Carter*, 83 Wash. 2d 136, 516 P.2d 767, 769 (1973). Merchants have apparently had no problem in dealing with the test.

[38] Under the UCC, a change in the purpose for which a good is used after the security agreement is executed will not change the good's classification. J. White & R. Summers, Uniform Commercial Code § 23-13 at 823-24 (1972). The cases cited in n.37, *supra* all follow this rule.

[39] *See supra* at 10, 15.

(p) (1980). Thus, where a credit account is opened primarily or predominantly for a consumer purpose, a few business transactions on it will not invoke the business purpose exemption. *See Gallegos* v. *Stokes*, 593 F.2d 372, 375 (10th Cir. 1979); *Smith* v. *Chapman*, 436 F. Supp. 58, 61-62 (W.D. Tex. 1977), *aff'd*, 614 F.2d 968 (5th Cir. 1980). Likewise, a transaction that is predominantly for a business or commercial purpose should be exempt from the Act; exclusive business use is not required. As Senator Proxmire stated in congressional debate prior to passage of the Act, the "bill would not cover . . . credit extended *primarily* for business or commercial purposes." 113 Cong. Rec. 18401 (1967) (emphasis added). *See Redhouse* v. *Quality Ford Sales, Inc.*, 511 F.2d 230, 235 (10th Cir. 1975); *Tower* v. *Home Construction Co.*, 458 F. Supp. 112, 116-17 (S.D. Ala. 1978).

The presumption spelled out by the District Court reflects underlying commercial realities, for a business obviously must be obtaining credit cards for a business purpose, even if this purpose is only to provide benefits to the employees. Only if this were so could the business justify deducting the card fees as an ordinary and necessary business expense. 26 U.S.C. § 162(a) (1976). By contrast, it is reasonable to presume that a card issued to an individual who is solely liable will more likely be used predominantly for personal, family, or household purposes.

In sum, the Court of Appeals below was incorrect in suggesting that § 104(1) could not be applied to credit cards because of difficulties in formulating a test for application of "any business exemption." As the district court found, the § 104(1) business purpose exemption is readily applied to a credit card by evaluating the prospective predominant use for which the card account is opened.

III. BECAUSE OF IMPORTANT AND FAR-REACHING DIFFERENCES BETWEEN BUSINESS CREDIT AND CONSUMER CREDIT, THE COURT OF APPEALS ERRED IN APPLYING THE REGULATORY FRAMEWORK OF THE TRUTH-IN LENDING ACT TO BUSINESS CREDIT.

Business credit takes a wide variety of forms that bear scant resemblance to the more familiar varieties of consumer credit. For this reason, the Truth-in-Lending Act, which was designed with consumer credit in mind, cannot easily be applied in the context of commercial credit. Other regulatory provisions have also recognized the basic differences between the two types of credit and have declined to impose the same regulatory schemes on business credit that they impose on consumer credit.

Moreover, the distinctions drawn between business and consumer credit typically turn on the purpose of the lending transaction, not the identity of the borrower. The reason is simple: the differences between business and consumer credit turn not on the nature of the borrower but on the underlying economic needs of the parties to the transaction. The Fifth Circuit erred in failing to accord proper weight to these differences.

A. The Economic and Practical Realities Underlying the Extension of Business Credit Differ Markedly from the Realities of the Consumer Credit Industry, and This Difference is Commonly Recognized in the Law

Businesses obtain financing through a wide variety of credit arrangements. The type of credit selected will depend on a number of factors, including the size of the business borrower, the available sources of funds, and whether financial needs are long- or short-term. Small businesses, for example, rely particularly on trade credit, which is generally extended by suppliers to their cus-

tomers on a continuous basis.[40] J. Wert & G. Henderson, Financing Business Firms 240-45 (6th ed. 1979). Larger corporations often borrow funds on the open market by selling commercial paper, which is a short-term obligation in the form of a promissory note maturing generally in three to six months. *Id.* at 245-48. Both large and small businesses borrow from commercial banks and other financial institutions under a wide variety of forms and with wide variation in security arrangements. Banks may lend money under letters of credit (including those used in international trade transactions) or through the purchase (often with recourse) of receivables. Banks may provide financing for fixed assets through purchase and lease-back arrangements. *Id.* at 277. Longer-term loans may be accompanied by various security arrangements, including those requiring the pledging of certain assets or the maintenance of accounts with compensating balances. *See id.* at 248-54.

One of the most common security arrangements in the field of commercial credit is a requirement that the owners of a business accept personal liability for the loan. Such a requirement is particularly common in the case of closely-held corporations, small businesses, or new businesses without an established credit record. Without personal liability, such businesses would be unable to obtain credit at acceptable rates and in adequate amounts.

The primary purpose for requiring personal liability is to provide sufficient security for the business debt. *See* W. Hawkland, Commercial Paper 92 (2d ed. 1979). When the principals of a business assume personal liability, creditors are afforded additional security and reasonable protection against diversion of the business assets by those principals. *See* J. Weston & M. Goudz-

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[40] Goods may be sold under a variety of credit terms, or various consignment or agency arrangements may be used to allow the business purchaser to finance inventories.

waard, Treasurer's Handbook 129 (1976). Personal liability is particularly important in the context of closely-held corporations, which

> as a matter of tax policy, show minimum profits and operate with a nominal net worth. Salaries paid to the principal stockholders are often larger than net profits, and the real net worth is represented either by loans made to the company by its principals, or by the net worth of the principals themselves. In such cases, sound policy requires that debt to stockholders be subordinated formally to bank debt and the bank obtain the endorsement or guarantee of the principals (and their wives) as additional protection.

H. Crosse, Management Policies for Commercial Banks 218 (1962).

Moreover, personal liability is commercially valuable beyond providing security to the business creditor. In the credit card context, for example, when a company account is opened, the agreement of an individual employee to assume personal liability acts as a form of constraint upon abuse by that individual. Such constraints are significant for both large and small companies because they allow the companies to control the risks attendant upon the adoption of company-wide credit programs. Such companies are then able to negotiate with card issuers to allocate the risk of unauthorized card use among the card issuer, employees, and the employer in a commercially sensible manner. The ability to make such arrangements affects the cost, availability, and terms of credit made available to large and small businesses alike.

In contrast to commercial credit, consumer credit comes in more familiar forms. The home mortgage, the automobile loan, the unsecured personal loan, and the revolving credit plan (typically offered through bank and retail credit cards) are the most common types of consumer

credit. *See, e.g., Financial and Business Statistics*, 66 Fed. Res. Bull. A-38 to A-41 (Dec., 1980). Some financial institutions, such as finance companies, savings and loan associations, credit unions, and mortgage companies, specialize in consumer credit. Even commercial banks that engage in consumer transactions typically do so through separate consumer lending or credit card departments.

The business purpose exemption in the Truth-in-Lending Act is founded on these differences between business and consumer credit. The distinction between business and consumer credit is a common one and is recognized throughout the law in a variety of statutory and regulatory frameworks. As in the Truth-in-Lending Act, this distinction often turns on an analysis of the primary purpose of the lending transaction, not on the identity of the borrower.

For example, the distinction appears prominently in the 1976 Amendments to the Equal Credit Opportunity Act, which give the Federal Reserve Board authority to "exempt from one or more provisions of [the Act] any class of transactions not primarily for personal, family, or household purposes. . . ." 15 U.S.C § 1691b(a) (1976). Congress defined consumer credit in this amendment not by reference to the identity of the obligor, but by reference to a personal, family, or household purpose for the loan. Because the Act's requirements, written with consumer credit in mind, did not work in the context of commercial credit and placed undue burdens on various standard commercial practices,[41] Congress felt an exemption was appro-

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[41] As an example of the burdens imposed by the statute, Senator Garn cited the requirement that written reasons be supplied for credit rejections, stating that such a requirement:

> . . . was not fashioned in the light of commercial practice. Commercial credit involves the extension of credit between

priate. *See* S.Rep. No. 589, 94th Cong., 2d Sess. 11 (1976).

The recent Executive Order establishing federal credit controls and the provisions of the Uniform Consumer Credit Code (UCCC) illustrate the same points. Pursuant to the Credit Control Act, 12 U.S.C. § 1904 (1976), the President in March 1980 directed the Federal Reserve Board to regulate consumer credit in an effort to prevent and control inflation. *See* Exec. Order No. 12,201, 45 Fed. Reg. 17123 (1980).[42] Limitations on business lending were accomplished under a separate, voluntary program. *See* 45 Fed. Reg. 22883 (1980). The UCCC, which regulates aspects of consumer credit on the state level, also uses definitions distinguishing between consumer and commercial credit.[43] In both the credit control and UCCC con-

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merchants for inventory stock, plant equipment, and the like. The very nature of most business to business relationships means that purchases are made frequently and continuously, often without a lot of red tape. Making this provision applicable to business credit would be very expensive and place impediments in the way of commercial transactions. The additional expense and paperwork would be astronomical and would not contribute to the achievement of the purposes of the Act.

S. Rep. No. 589, 94th Cong., 2d Sess. 21 (1976) (Additional Views of Senator Garn).

[42] Consistent with the President's Order, the Board issued regulations requiring the maintenance of non-interest-bearing deposit accounts with the Federal Reserve by issuers of certain common forms of consumer credit, such as credit cards, personal loans, and overdraft credit plans offered by financial institutions. Credit extended for business purposes, regardless of the identity of the borrower, was specifically excluded from these regulations. *See* 45 Fed. Reg. 17927 (1980). Significantly, the regulations explicitly recognized that credit extended through the use of credit cards could be granted for either consumer or business purposes and excluded business use of credit cards from the deposit requirements. *See* 45 Fed. Reg. 17928 (1980).

[43] See U.C.C.C. §§ 1.301(12) (defining "consumer credit sale"); 1.301(15) (defining "consumer loan") (1974) text).

texts, the approach used in Truth-in-Lending is adopted: consumer and commercial credit are distinguished by reference to the purpose of the transaction, not by the identity of the obligor. In fact, the definitions of covered consumer credit transactions under the UCCC are almost identical to those in the Truth-in-Lending Act because of the mutual influence of the two statutes on each other.[44]

B. The Court of Appeals Was Not Free to Disregard the Distinction Between Business and Consumer Credit and to Rewrite the Truth-in-Lending Act Based on Its Own Concept of Equity

Courts are under an "obligation to honor the clear meaning of a statute, as revealed by its language, purpose and history." *Southeastern Community College* v. *Davis*, 442 U.S. 397, 411 (1979) *quoting International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 566 n.20 (1979). Here, it is clear beyond all serious doubt that a credit transaction having a business or commercial purpose is exempt from the Truth-in-Lending Act regardless of the identity of the obligor, with the limited and inapplicable exceptions previously discussed. In ruling that the business purpose exemption does not apply

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[44] *See Prefatory Note to 1968 Revised Final Draft* and *Comments to the Official 1974 Text*, VII U.L.A., Business and Financial Laws 240, 584 (1978). *See also* Warren & Larmore, *Truth in Lending: Problems in Coverage*, 24 Stan. L. Rev. 793, 795 (1972).

Under both the Truth-in-Lending Act and the UCCC, covered credit transactions must be made to a natural person; must be primarily for personal, family, or household purposes; and must be for less than $25,000 in most circumstances. *Compare*, 15 U.S.C. § 1602(h) (1976) and 15 U.S.C. § 1603(3) (1976) *with* U.C.C.C. § 1.301(12) (1974 text). The UCCC includes "agricultural purposes" within the definition of covered consumer credit transactions, although reference to "agricultural purposes" will be struck from the Truth-in-Lending Act, effective March 31, 1982. Truth-in Lending Simplification and Reform Act, §§ 603(a), 625(a), Pub L. 96-221, 94 Stat. 132 (1980).

where an individual assumes liability for the business debt, the Court of Appeals disregarded the language, purpose, and history of the Truth-in-Lending Act, as well as administrative interpretation of the Act and previous case law. Instead, the Court of Appeals relied upon its own concept of equity and the colorful old adage "You cannot have your cake and eat it too." (Pet. App. at 2a. *See also* Pet. App. at 10a.) But courts are not permitted to rewrite statutes to satisfy their own notions of fairness. As this Court has stated, "the judiciary may not sit as a superlegislature to judge the wisdom or desirability of legislative policy determinations made in areas that neither affect fundamental rights nor proceed along suspect lines." *New Orleans* v. *Dukes*, 427 U.S. 297, 303 (1976).[45]

Under the holding of the Fifth Circuit, the full regulatory framework of the Truth-in-Lending Act would apply whenever an individual is personally liable on a business debt. But the Act was designed only for consumer credit and cannot practically be applied in the commercial credit context. The specific disclosure requirements found in the Act and the regulations do not in many cases make sense in the commercial context. A number of specific examples illustrate the point.

Trade credit does not readily fit into the Truth-in-Lending framework. As the discussion above indicates, trade credit is often extended by suppliers to their customers on a more or less continuous basis and is frequently transacted informally with a minimum of paperwork. Whether or not the owners of a small business are personally liable to suppliers, the procedures used are the same. Customer orders for supplies, and accompanying extensions of credit by the supplier, often are made over

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[45] *See Exxon Corp.* v. *Governor of Maryland*, 437 U.S. 117, 124 (1978); *Ferguson* v. *Skrupa*, 372 U.S. 726, 731-32 (1963); *Day-Brite Lighting* v. *Missouri*, 342 U.S. 421, 423 (1952).

the telephone. Purchase orders and invoices with preprinted terms may constitute the agreement and may be sent either before or after shipment. If Truth-in-Lending applied, however, the regulations would require that in most circumstances written disclosures be made before or at the time of the delivery of the property. *See* 12 C.F.R. § 226.8(g) (1980); 12 C.F.R. § 226.802 (1980) (Board Interpretation). Compliance with this requirement would be both unnecessary and burdensome, particularly in the case of customers and suppliers who have a long-standing relationship where the terms of the credit are well known to both parties.

Commercial lending by banks and other financial institutions is equally incompatible with Truth-in-Lending requirements. Regulation Z simply is not designed to deal with the complications of the wide variety of security and escrow arrangements that commercial lenders may require of business borrowers, whether or not personal liability attaches to the loans. For example, although Regulation Z contains provisions dealing with the maintenance of required deposit balances in the context of consumer loans, *see* 12 C.F.R. § 226.8(e) (1980), these provisions are simply inadequate to explain how disclosures would be made under many common commercial practices, which may include requirements that securities be pledged or delivered to the lender or that compensating balances of various types over varying periods of time be maintained.[46]

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[46] Although 12 C.F.R. § 226.8(e) (1980) provides four exceptions to the rule that deposit balances and other required investments must be excluded from the dollar amount disclosed as the amount financed, these four exceptions (including, *inter alia*, escrow accounts for taxes and insurance and pre-existing investments offered as security) were devised to meet common consumer lending situations and are not broad enough to embrace the wide variety of business credit arrangements. Thus certain investments maintained by a business borrower to satisfy the conditions of a business loan

The Truth-in-Lending framework is also difficult to apply in the business credit card area involved in this case. Billing systems designed for company card accounts, like the John E. Koerner & Co., Inc., company account, are different from those offered holders of non-business American Express cards, to whom the Truth-in-Lending Act applies. For example, companies with large numbers of employee cards issued on a single company account may request bills on microfilm or magnetic tape, or companies can elect an arrangement where statements for airline charges and/or annual card fees are sent directly to the company, while employees receive statements for all other charges and then obtain reimbursement from the company.

Applying the complications of Regulation Z to such billing systems would pose a number of difficult—and wholly unnecessary—problems. For example, present regulatory requirements detailing the size of type to be used on periodic statements or specifying that certain terms must be more prominently displayed than others, *see* 12 C.F.R. § 226.6(a) (1980), make no sense for bills sent on mag-

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might have to be excluded from the amount financed, thereby increasing the disclosed finance charge rate. For example, the value of securities not in existence at the date of the loan and subsequently delivered to the lender as collateral would have to be excluded from the amount financed if the regulation applied, while the exclusion would not be required if the securities pre-existed the date of the loan. *See* 12 C.F.R. § 226.8(e)(2)(iii) (1980). This distinction makes no sense in a business context.

The Truth-in-Lending Act is also not designed for applicability to commercial borrowing mechanisms such as the sale of commercial paper. Under the Act and the regulations, disclosure obligations are placed on the lender. *See* 12 C.F.R. § 226.8(a) (1980). But the "lender" in a commercial paper transaction is the buyer of the issuing corporation's note. In this context, the Act's lender disclosure scheme would make no sense. Although commercial paper is a form of commercial credit where personal liability is unlikely to be involved, it nevertheless provides another example of how the Act cannot easily be applied in the commercial context.

netic tape, or even on microfilm. Splitting a bill into two parts and sending a statement for a portion of the total to an employee while asking for the balance from the employer may be inconsistent with requirements for specifying an entire "new balance" on a single periodic statement. *See* 12 C.F.R. § 226.7(b)(1)(ix) (1980).

The billing error provisions, which are involved in this case, also raise problems. The record here shows that some of the errors alleged to exist in the Koerner company account related not to Respondent Koerner, but to other employees of the company. (J.A. at 35a, 40a-41a.) The errors were asserted not by Koerner, but by the company on company stationery. (J.A. at 38a, 43a.) Given situations in which thousands of cards—or even five cards—may be issued on a single company account, the existence of an alleged error with respect to any single card on the account might make it impossible for any other card to be cancelled while the dispute is being processed.

The solution to these problems is not to eliminate the requirement for personal liability on business credit cards. Personal liability serves a number of important commercial purposes, and sacrificing them would needlessly distort underlying economic realities. First, holding an employee personally responsible for debts on his company card protects against abuse of the card. Second, the availability of personal liability allows the card issuer and the employer to negotiate a division of liability for unauthorized use of business cards, as authorized under § 135 for business customers holding ten or more cards. *See supra* at 21-24. The ability to negotiate a division of liability has a direct effect on the cost and availability of credit to the company. Card issuers can be expected to agree to absolve companies from liability only if the card issuer has an alternative source from which to obtain payment in the case of unauthorized employee use of the card.

The regulatory structures designed for consumer credit cannot be engrafted onto commercial credit systems except at wholly unnecessary cost. Because requirements for personal liability serve important business needs, it would make no sense to require that such liability be avoided in order to assure exemption from consumer credit laws and the complicated compliance procedures that go with them. Neither Congress nor the Federal Reserve Board has mandated such a result, and the Fifth Circuit therefore erred in requiring it.

CONCLUSION

For the reasons set forth above, the judgment of the Court of Appeals should be reversed, and the judgment of the District Court reinstated.

Respectfully submitted,

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